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VIA EMAIL

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and

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Dear Sirs/Mesdames:

Re: *Proposed Derivatives Rule Modernization, Stage 1* (the “Proposed IROC Rules”)

The Canadian Advocacy Council of CFA Societies Canada¹ (the “CAC”) appreciates the opportunity to provide the following general comments on the Proposed IROC Rules and to respond to certain of the specific questions for which feedback is sought.

We are supportive of IROC’s initiatives to review its Dealer Member rules for consistency with proposed CSA rules and to identify necessary clarifications, as well as identify inconsistencies in the treatment of listed and OTC derivatives. We believe IROC should continue to consider how best to reduce regulatory burden without having a negative impact on investor protection, including by harmonizing rules where possible. We also agree with IROC’s stated objectives in connection with the Proposed IROC Rules, which includes reducing regulatory arbitrage opportunities and creating consistent regulation of securities and derivatives-related activities by Dealer Members.

¹ The CAC is an advocacy council for CFA Societies Canada, representing the 12 CFA Institute Member Societies across Canada and over 18,000 Canadian CFA charterholders. The council includes investment professionals across Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. Visit www.cfacanada.org to access the advocacy work of the CAC.

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors’ interests come first, markets function at their best, and economies grow. There are more than 171,500 CFA charterholders worldwide in 164 markets. CFA Institute has nine offices worldwide and there are 158 local member societies. For more information, visit www.cfainstitute.org.

We agree with the proposal to broaden the definition of a derivative to detail the general features of a derivative and thus capture more instruments than futures contracts, futures contract options and options. We believe this is a helpful investor protection measure, as almost any kind of instrument can be packaged into an OTC derivative and sold to retail investors. A broad set of definitions will also help ensure that all relevant investment products will be covered by one of the definitions of a derivative, listed derivative or OTC derivative, even if the products change over time. We note however, that the definition of a listed derivative should not inadvertently include an ETF.

While we agree that it is important that the definitions be consistent with the definitions set out in securities legislation, we note that a Canadian-only focus may be problematic given Canada's small percentage of the derivatives trading market. International derivatives participants are continuing to advance definitions and standards for the global derivatives marketplace, and it is important that the final definitions and scope of the rules be compatible with such evolving international standards. For example, ISDA has developed the ISDA Common Domain Model™, a machine readable and executable data model for derivatives products, which we understand is intended to deal with the lack of standard conventions for how derivatives trades and processes are represented.

With respect to the required monthly account statement, we are of the view that the economic exposure of the derivative product should be reported together with the market value, cash positions and other features of the derivative. The market value of a futures contract is virtually zero (as variation margin is exchanged daily) but the exposure of the contract could be material. Similar considerations apply to total return swaps and CFDs, in that while the market value might be small (because pricing resets monthly or quarterly), the exposure might be large. The economic exposure of the product can help illustrate the "economic leverage" of a derivative, which is implied leverage in the return calculation. We understand that institutional investors would typically report the economic exposure.

IIROC is proposing to extend a number of general business conduct rules to derivatives-related activities. We are particularly supportive of the proposal to amend IIROC rules to require that the best execution obligation apply to all derivatives orders and transactions and include specific best execution considerations for listed derivatives and fair pricing considerations for OTC derivatives.

We understand that a detailed review of proficiency and CE requirements for persons dealing in derivatives will be forthcoming at a later date. We look forward to the possibility of commenting on any such proposals.

Specific Questions

Question #1 We have included individuals in the proposed definition of institutional client. We have done so on the basis that individuals and non-individuals that meet the same conditions should be treated as equally sophisticated under our rules, provided that the individuals request and consent to waiving their retail client protections. Do you

agree that we should allow certain qualifying individuals to be able to request and consent to being classified as institutional clients?

The current proposal would consider an individual to qualify as an institutional client if they hold more than \$10 million of total securities and precious metals bullion under administration or management if they request and consent to being classified as an institutional client.

We note that caution is warranted prior to expanding the definition on the basis of financial assets which is not in all cases a proxy for investor sophistication. As noted in our response to a consultation by the Alberta Securities Commission, ASC Consultation Paper 11-701 *Energizing Alberta's Capital Market*, we are open to the potential of expanding certain definitions, such as the accredited investor exemption and in this proposal, the institutional client definition, in certain circumstances. We would support, for example, alternative qualifications to financial assets such as persons who have obtained educational qualifications that would be required for an individual to obtain registration by the CSA as an adviser or dealer in derivatives. If such alternative were available, the rationale would recognize both the ability to withstand loss and/or the ability to understand loss. As a result it may be more prudent to allow specific individual investors to apply for an exemption to be treated as an institutional client if they have the appropriate education and experience with derivatives.

Question #2 We have included hedgers in the proposed definition of institutional client and have not:

- *limited qualifying hedging activities to those involving OTC derivatives; or*
- *required that the hedger meet a minimum financial assets threshold.*

We have done so on the basis that:

- *our rules recognize numerous qualifying hedges that that do not involve OTC derivatives; and*
- *sophisticated hedging activities are commonly undertaken by clients with limited financial resources.*

Do you agree that IIROC should include a hedger category within its institutional client definition and that this category include all hedging activities rather than hedging activities involving OTC derivatives?

Do you agree that meeting a minimum financial assets threshold is unnecessary to qualify as a hedger? If you don't agree, at what level should IIROC set a minimum financial assets threshold for hedgers?

We agree that hedgers should be included in the proposed definition of an institutional client, and that the category should include all hedging activities rather than hedging activities only involving OTC derivatives. We agree that it should not be necessary for a hedger to meet a minimum financial asset threshold to qualify as such, as many sophisticated strategies can be implemented using leverage or at zero cost (e.g. long/short strategies with derivatives).

Question #3 Is the concept of hedger well defined? How could the definition of hedger be improved?

We agree that the meaning of “hedger” should be consistent with definitions currently in use by the CSA, and that the guidance and examples provided are helpful, although they should be updated as market practices evolve so that everyone is working with the same information and expectations. Correlations change over time, and proxy hedges or basis hedges can be difficult to distinguish from investment or speculation. In addition, parts of the definition of “hedger” do seem redundant and could be streamlined, as components of the definition are all different ways of saying that the value of the risk being hedged is related to the value of the transaction.

Question #4 We have not narrowed the scope of the proposed business continuity plan requirement amendments to only apply to significant client access or liquidation impairments involving derivatives as we believe that significant impairments can occur when any type of investment product is involved. We do, however, recognize that the nature of the impairments and the dealer’s ability to resolve the impairment can vary.

To address this variability we plan to issue guidance to assist dealers in determining when their business continuity plan must be invoked in response to a significant client access or liquidation impairment. What considerations do you think this guidance should itemize in determining when a dealer should invoke their business continuity plan?

We respectfully note that implementing a BCP may not necessarily be the best course of action for a Dealer Member, depending on the specific circumstances of the disruption, particularly for a cyber-related disruption. We do support the requirement to inform IROC of any such disruption.

Question #7 In an effort to provide clients with one disclosure document that summarizes the important risks that are generally applicable to transacting in derivatives, we have eliminated the discussion of risks specific to options, futures and futures contract options and have instead included a general discussion of the important risks relevant to transacting in all types of derivatives. Have we captured all of the important risks relevant to derivatives in this proposed revised Derivatives Risk Disclosure Statement? If not, please provide details of other risks we should discuss.

The proposed Derivatives Risk Disclosure Statement is significantly more general than the current version. Although it contains general language to the effect that not all risks related to derivatives trading are listed, we believe it should reference common specific risks such as volatility risk and time risk.

The counterparty risk for OTC derivatives is an important consideration and should be explained, particularly for the benefit of individuals who qualify as institutional investors. The complexity embedded within an OTC derivative product ought to be expanded upon, along with risks related to how cash flows are calculated. In addition, it is important to add a reference to the potential risk of a clearinghouse failure or failure of a clearinghouse member for listed derivatives.

As noted above in our general comments, we believe that any risk disclosure document should be consistent with evolving international standards and frameworks.

Question #8 Have we identified all of the proposal provisions that will materially impact clients, Dealer Members or IIROC? If no, please list other proposal provisions that you believe will materially impact one or more parties and why.

In order to further consider whether there are additional proposal provisions that will materially impact clients, Dealer Members or IIROC, it would be helpful to examine those provisions in light of evolving global frameworks for derivatives trading to which Canadian counterparties would be expected to adhere.

Question #9 Overall, IIROC has qualitatively assessed that the benefits of these proposals exceed their costs. Do agree with IIROC's assessment? If so or if not, please provide reasons why.

We support IIROC's process of assessing the benefits of the proposal in light of the potential costs. We are of the view that elements of the proposals do materially resolve in favour of investor interests.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council of
CFA Societies Canada*

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